BEFORE THE ARIZONA CORPORATION COMM

COMMISSIONERS

KRISTIN K. MAYES - Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF ARIZONA WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY, AND FOR ADJUSTMENTS TO ITS RATES AND CHARGES FOR UTILITY SERVICE AND FOR CERTAIN RELATED APPROVALS BASED THEREON.

Docket No. W-01445A-08-0440

CERTIFICATE OF COMPLIANCE FILING

In Decision No. 71845 of the Arizona Corporation Commission (the "Commission") entered on August 24, 2010, in the above-captioned docket, the Commission ordered Arizona Water Company (the "Company"), at page 94 of the Decision, to "… prepare a study outlining consolidation proposals, inclusive of a full-system-wide single-tariff consolidation option, which details possible timelines and pursues paths of least impact for customers…and file a report detailing the results of the study by June 30, 2011, but no later than three months prior to filing its next rate case with Docket Control as a compliance item in this docket…".

The Company hereby files its Consolidation Study in compliance with the foregoing order.

RESPECTFULLY SUBMITTED this 30th day of September 2010.

ARIZONA WATER COMPANY

By: Robert Geake

Robert W. Geake
Vice President and General Counsel
Arizona Water Company
P. O. Box 29006
Phoenix, AZ 85038
Attorney for Applicant

AN ORIGINAL and thirteen (13) copies of the foregoing filed this 30th day of September, 2010 with:

Docketing Supervisor
Docket Control Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

A copy of the foregoing was mailed this 30th day of September, 2010 to:

Dwight D. Nodes
Assistant Chief Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Wesley C. Van Cleve, Attorney
Nancy L. Scott, Attorney
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Michelle Wood, Attorney
Residential Utility Consumer Office
1110 West Washington Street, Suite 220
Phoenix, Arizona 85007

Nicholas J. Enoch
Jarrett J. Haskovec
Lubin & Enoch, PC
349 North Fourth Avenue
Phoenix, Arizona 85003
Attorneys for IBEW Local 387

Michelle Van Quatham
Ryley, Carlock & Applewhite
One North Central Avenue, Suite 1200
Phoenix, Arizona 85004
Attorneys for Abbott Laboratories

By: Robert Geake

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In Decision No. 71845, the Arizona Corporation Commission (the "Commission") directed Arizona Water Company ("Company") to prepare a study outlining consolidation options, including an option for full, system-wide, single-tariff consolidation. A report of the study is to be filed with the Commission by June 30, 2011, but no later than 90 days prior to filing its next rate case. This consolidation study complies with Decision No. 71845 and addresses the following: (1) two different consolidation options; (2) impacts on residential customers; (3) possible timelines for implementation; and (4) potential efficiencies from consolidation.

The Company is a public service corporation engaged in providing public utility water service in portions of Cochise, Coconino, Gila, Maricopa, Navajo, Pima, Pinal and Yavapai Counties, Arizona, pursuant to certificates of convenience and necessity granted by the Commission. Currently, the Company operates 19 water systems which serve approximately 84,500 customers.

The Company's 19 water systems are organized into three groups: Northern, Eastern and Western. In Decision No. 58120, the Commission expressly authorized the Company to implement and utilize the three groups for filing rate applications to simplify processing and increase administrative efficiency. For management purposes, these three groups are further subdivided into six divisions, 11 systems and 13 sub-systems. Each division shares managerial, operating and customer service employees within each water system they manage. Additionally, the water systems within each division are located in the same general area of the state and share similarities in water resources. The chart below shows each of the systems by division and group. Note that several divisions have been renamed to better identify consolidated systems within the divisions.

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Group	Division	System (• Sub-system)
Northern Group		
	Navajo Division	
	(formerly Lakeside Division)	Navajo • Lakeside[1] • Overgaard[1]
	Verde Valley Division	
	(formerly Sedona Division)	Verde Valley • Sedona[2] • Rimrock[1] • Pinewood[1]
Eastern Group		
	Superstition Division	
		Superstition • Apache Junction[1] • Superior[1] • Miami[1]
	Cochise Division	
	(formerly Bisbee Division)	Cochise • Bisbee[2] • Sierra Vista[2]
	Falcon Valley Division	
	(formerly San Manuel Division)	San Manuel
		Oracle
		SaddleBrooke
		Winkelman
Western Group		
	Pinal Valley Division	
	(formerly Casa Grande Division)	Pinal Valley • Casa Grande[1] • Coolidge[1] • Stanfield[2]
		White Tank
		Ajo

[1]Fully consolidated in Decision No. 71845
[2]Partially consolidated in Decision No. 71845

Prior to Decision No. 71845, these 19 systems and sub-systems all had separate rates. However, in Decision No. 71845, the Commission authorized five full system consolidations and three partial consolidations, thereby reducing the number of separate systems for rate purposes from 19 to 14. When the current partially consolidated systems achieve full consolidation, the number of systems with separate rates will be reduced to 11.

Study Methodology and Company's Consolidation Principles

To develop the options in this study, the Company relied on the same rate design model that it used in Docket W-01445A-08-0440, which the Commission adopted in Decision No. 71845. The starting point for the comparison is the current rate for each system that was determined using a 2007 test year. The options were developed on the basis of a 2009 test year, to reflect the effects of the Company's greater investment in utility plant, higher operating expenses, and more up-to-date customer counts than in the recently adopted 2007 test year.

In Decision No. 71845, the Commission approved the Company's proposed rate consolidation which was based on the following principles:

- Rate consolidation should produce average residential bills that are at or below the cost of service.[1]
- Changes to rate design should reflect gradualism.[2]
- Operational consolidation (which would include regulatory, accounting, operations, and ratemaking functions) should be implemented when the Commission approves the consolidation.
- Rates should be consolidated partially where full rate consolidation is not yet feasible.
- Systems with higher rates should have their rates frozen until the rates in the other systems in the consolidated group reach that level.
- Consolidation is ideally made along functional relationships which share management, operating employees, and customer service.[3]
- Areas consolidated should share similarities in water resources.
- Areas consolidated should have similar rate structures.

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[1] Docket W-01445A-08-0440 Direct Testimony of Joseph D. Harris, pg, 14, lines 1-9
[2] Docket W-01445A-08-0440 Direct Testimony of Joel M. Reiker, pg, 35, lines 6-25
[3] Docket W-01445A-08-0440 Direct Testimony of William M. Garfield, pg, 34, lines 1-8

The Company followed these same principles in formulating the consolidation options in this study.

The Consolidation Options

Option 1: Company Proposed – Continue Consolidating Within Systems in Phases

A. Northern Group
   i. The Navajo system would remain fully consolidated.
   ii. Verde Valley system (Sedona, Rimrock, Pinewood)
      a. Fully consolidate rates in phases until all sub-systems' rates can be equalized without rate reductions
B. Eastern Group
   i. The Superstition system would remain fully consolidated.
   ii. Cochise system (Bisbee, Sierra Vista)
      a. Fully consolidate rates in phases until both sub-systems' rates can be equalized without a rate reduction
   iii. Falcon Valley Division (San Manuel, Oracle, SaddleBrooke, Winkelman)
      a. Fully consolidate all systems in the Division operationally
      b. Fully consolidate rates in phases until all systems' rates can be equalized without rate reductions
C. Western Group
   i. Pinal Valley system (Casa Grande, Coolidge, Stanfield)
      a. Operationally consolidate the White Tank system into the Pinal Valley system
      b. Fully consolidate rates in phases until all sub-systems' rates can be equalized without rate reductions
   ii. Ajo system
      a. The Ajo system to remain operationally unconsolidated and will continue to have separate rates because it does not share similarities in water resources with the other systems in the Pinal Valley Division.

All of the Option 1 consolidations would occur along functional lines and combine sub-systems that share management, operations and customer service employees. The partial rate consolidations were created to minimize the impact on customers while still charting a path towards eventual full rate consolidation within a system.

Table 1 shows the Option 1 effect on monthly water bills for residential customers with a ⅝" x ¾" meter using 7,500 gallons of water per month and the annual revenue effect on each system.

Timeline and Customer Impact

Option 1 consolidations could begin with the Company's next rate filing. The Company will be filing the Western Group first, followed annually by the Eastern Group, then the Northern Group. If regulatory timelines for rate case proceedings are followed, the consolidations could be accomplished in four years. Option 1 produces typical residential bills that are equal to or less than the cost of service with the least impact on customers.

Option 2: Statewide Consolidation – Fully Consolidate All Systems

Option 2 of the study examined consolidating all of the Company's systems with a single set of statewide tariff rates for all systems. In many instances, Option 2 consolidation crosses management and operating lines, thereby requiring significant restructuring of the Company's management teams. Also, it would detrimentally alter customer water use patterns and encourage excessive water use by customers in the Northern Group systems which have limited groundwater supplies.

Table 1 shows the Option 2 effect on monthly water bills for residential customers with a ⅝" x ¾" meter using 7,500 gallons of water per month and the annual revenue effect on each system.

Timeline and Customer Impact

Option 2 consolidations could only be implemented with a Company-wide rate filing. If regulatory timelines for rate case proceedings are followed, full operational consolidation could be accomplished within a single three-year ratemaking cycle. Unlike Option 1, this consolidation option produces revenues that exceed the residential cost of service for several systems (Sierra Vista, Winkelman and Sedona). It also causes significantly larger revenue imbalances between a number of the consolidated systems which would cause the Pinal Valley system (Casa Grande, Coolidge, and Stanfield) to be burdened by more than $4 million in additional revenue requirements. Those additional revenues would be reallocated from the remaining systems, which would then have unjustifiably reduced rates. Besides the significant residential customer rate impacts, Option 2 deviates from and undermines the greater functional, operational, and managerial efficiencies achievable under Option 1. Option 2 is not desirable because it causes significant revenue imbalances between some of the systems (because of unjustifiable rate reductions) and encourages higher customer water use in systems where water supplies are scarce.

Benefits of Consolidation

Benefits of rate consolidation for customers, regulators, and the Company as a whole, depend upon the approaches taken in consolidating systems. Primary among these benefits are:

- Mitigate rate impacts to utility customers by smoothing the effect of discrete cost spikes across systems and over time.
- Improve affordability of services in smaller systems.
- Achieve value of service parity to the extent that all customers in a specific geographic area pay the same rates for comparable service.
- Improve overall operational efficiency by encouraging utility plant investments in systems based on need and not based on whether an individual system could sustain the resulting costs of such investments.
- Streamline administrative and regulatory processes, thereby producing efficiencies that minimize costs, especially costs related to accounting and ratemaking.
- Improve and further ensure affordability of water service in all systems.

Efficiencies through Consolidation

Consolidating systems operationally offers a number of efficiencies which can produce long-term gains in productivity. These gains primarily are achieved by eliminating the need to maintain detailed cost records at a discrete individual system level and will result in significant reductions in employee man-hours each day. For example, consider the 125 employees who typically are involved in this type of operational reporting for payroll and invoice coding in the three groups. Assuming that each of these employees will save as little as 12 minutes every work day (which is a conservative assumption), the Company would achieve 25 hours per day in increased productivity. If a typical work year is 240 work days (excluding holidays and vacations), the Company would realize a productivity gain of 6,000 hours over the course of a year. Consolidating accounting records would lead to similar productivity gains. By consolidating systems, the number of cost reports, schedules and analytics is reduced. Assuming two hours saved per system per month, each consolidation of a system could lead to a productivity gain of 72 hours per year company-wide.

The regulatory and ratemaking process is another area where significant savings can be achieved. Of the Company's general rate case legal costs incurred in this Docket, approximately $18,000 were related to consolidation. Though likely to recur in future cases involving consolidation, these costs will decline and eventually be eliminated.

Also in this Docket, the Commission Staff required an additional 90 days to process the rate filing, in part due to the number of separate rate systems, and Staff and other parties required an additional four weeks of time to prepare rate-related testimony. In total, this represented four months of additional effort. Even achieving a 50% reduction in this effort would yield a substantial productivity gain for the Commission itself.

Conclusion

The Company remains committed to consolidations following a principled and conservative approach, having first proposed consolidations in its 2000 rate case for its Northern Group systems – Sedona, Rimrock, Pinewood, Lakeside and Overgaard. The Company's consolidation principles, which the Commission affirmed in Decision No. 71845, should be applied as guidelines in pursuing a path to further consolidations. For this reason, the Company recommends the consolidation strategy outlined in Option 1, which it will begin pursuing in its next rate case. Option 1 continues the work started in Decision No. 71845 and extends it in a logical and reasonable manner. It is preferable to Option 2 because, as the Commission required in Decision No. 71845 (page 94, line 13) it "pursues paths of least impact for customers."

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Table 1

Line No.	System / Sub-system	Monthly Residential Bills[1] Current	2009 Test Year Option 1	2009 Test Year Option 2	System / Sub-system	Annual Revenue Effect (From) / To Option 1	Annual Revenue Effect (From) / To Option 2
	Northern Group				Northern Group		
1.	Navajo System				Navajo System		
2.	Lakeside / Overgaard	$ 48.57	$ 50.81	$ 38.81	Lakeside / Overgaard	$ -	$ (484,950)
4.	Verde Valley System				Verde Valley System		
5.	Sedona	$ 36.31	$ 43.01	$ 38.81	Sedona	$ 248,837	$ (365,084)
6.	Rimrock / Pinewood	$ 52.33	$ 52.33	$ 38.81	Rimrock / Pinewood	$ (248,837)	$ (618,891)
7.							
8.	Eastern Group				Eastern Group		
9.	Superstition System				Superstition System		
10.	Apache Junction / Superior / Miami	$ 37.20	$ 42.90	$ 38.81	Apache Junction / Superior / Miami	$ -	$ (1,683,135)
11.	Cochise System				Cochise System		
12.	Bisbee	$ 44.44	$ 44.44	$ 38.81	Bisbee	$ (258,963)	$ (481,864)
13.	Sierra Vista	$ 25.11	$ 32.10	$ 38.81	Sierra Vista	$ 258,963	$ 610,458
14.	Falcon Valley Division				Falcon Valley Division		
15.	San Manuel	$ 44.83	$ 48.56	$ 38.81	San Manuel	$ 39,058	$ (196,835)
16.	Oracle	$ 55.12	$ 55.12	$ 38.81	Oracle	$ (9,253)	$ (282,667)
17.	SaddleBrooke	$ 45.75	$ 55.12	$ 38.81	SaddleBrooke	$ (52,320)	$ (86,220)
18.	Winkleman	$ 27.31	$ 36.59	$ 38.81	Winkleman	$ 22,515	$ 33,327
19.							
20.	Western Group				Western Group		
21.	Pinal Valley System				Pinal Valley System		
22.	Casa Grande / Coolidge	$ 27.61	$ 34.67	$ 38.81	Casa Grande / Coolidge	$ 541,014	$ 4,111,622
23.	Stanfield	$ 36.82	$ 36.82	$ 38.81	Stanfield	$ (46,879)	$ (32,212)
24.	White Tank	$ 36.94	$ 36.94	$ 38.81	White Tank	$ (494,135)	$ (357,774)
25.	Ajo	$ 66.72	$ 60.44	$ 38.81	Ajo	$ -	$ (165,775)
26.							
27.							
28.							
29.							
30.	[1] Monthly Residential bills based on 5/8" X 3/4" meter and 7,500 gallons of usage.						
31.							
32.							
33.							
34.							